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Poor relations

Are third-world commodity producers condemned to eternal poverty?

ECONOMICS FOCUS

THE boom in developing economies in Asia and Latin America has attracted much attention. So it is fitting that the 1994 edition of the World Bank's "Global Economic Prospects and the Developing Countries" focuses on the less promising prospects of low-income commodity producers.

Countries where manufactured goods accounted for at least 50% of total exports enjoyed average annual GDP growth of 6.8% between 1980 and 1992. Diversified exporters grew by 3.6%. However, those that exported mainly non-oil commodities grew by only 1.4%—so slowly, in fact, that their real income per head declined.

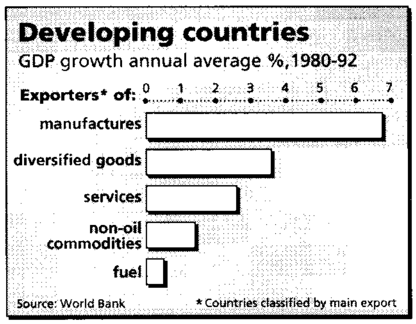
The 35 countries (26 in Africa) which the World Bank categorises as low-income commodity producers have an average GDP per head of only $420. They contain 31% of the world's population, but contribute only 3% of total output. In 1992 their average income per head was only 46% of the average for all developing countries, down from 63% in 1960. Does dependence on commodities act as a permanent brake on economic growth?

Since 1980 average commodity prices have dropped by more than half in real terms. This represented an annual loss to developing countries of $100 billion in 1993, almost twice what they received in foreign aid. Behind this slide lies the fact that world trade in commodities has grown far more slowly than trade in manufactures and services. One reason is that, as countries get richer, the share of income spent on food shrinks. A second factor is the shift within economies to activities that use fewer raw materials. Combined with the introduction of synthetic substitutes, this has reduced the demand for some metals.

Most forecasters expect commodity prices to recover modestly over the next couple of years as industrial economies rev up, but then to stabilise at best over the coming decade. Since nobody is predicting a commodity boom, can commodity producers grow faster only if they shift their output and exports into other sectors as quickly as possible?

Many of today's successful developing countries used to be heavily dependent on primary products. In 1965 commodities made up 89% of Malaysia's exports; today their share is only 28%. Some might conclude that it was because Malaysia shifted out of commodities that its economy has done so well since. They are wrong. Malaysia's agricultural output has boomed. Palm-oil production has risen more than 16-fold since 1970, while cocoa output has soared from 3,000 tonnes in 1970 to 225,000 in 1993. Indonesia, Thailand and Chile provide further examples of dramatic expansion of farm exports over the past two decades, at the same time as their reliance on commodities fell.

The experience of these economies suggests that successful diversification away from commodities was itself triggered by efforts to boost output and productivity in their primary sectors. According to evidence presented by the World Bank, total factor productivity growth (ie, the increase in output that is not explained simply by the use of more labour and capital) is just as high, if not higher, in agriculture as in manufacturing. This means that commodity-exporting countries are not necessarily condemned to pitiful growth.



What happened in successful countries, such as Malaysia, is that rising productivity in agriculture, spurred by newer technology and more efficient marketing methods, allowed countries to produce more with fewer workers, releasing labour into manufacturing. The implication, however strange it seems, is that commodity exporters can best accelerate diversification and lift their growth rates by boosting the efficiency of primary-product industries. Governments can encourage this by lowering trade barriers and opening up to foreign direct investment, which then provides a springboard for diversification.

In contrast, many African countries adopted policies which stunted the growth of agriculture (eg, import barriers on manufactured goods such as tractors, and export taxes on farm produce). As a result, not only has Africa remained heavily dependent on primary commodities, but its market share has dwindled. The continent's share of world coffee production, for example, has shrunk from 29% to 15% over the past two decades.

The World Bank admits that the extent to which Sub-Saharan Africa can copy Malaysia, say, is limited by countries' low levels of physical and human capital. Even so, they can still achieve big efficiency gains in commodity production and export.

There is a wrinkle. If all commodity exporters tried to boost their exports simultaneously, that would reduce prices. Indeed, net export revenues could even fall. The World Bank reckons that this is a problem only for coffee, cocoa and tea. For other commodities, a rise in volume would bring a rise in net revenues. And even for tropical beverages, it says, policies which boost efficiency in production and marketing are likely to achieve more lasting gains in net revenues than export quotas or taxes.

Derivatives for development

Supply shocks such as bad harvests make the prices of commodities twice as volatile as those of manufactures. This is a particularly serious problem for countries such as Zambia, Rwanda and Uganda, where a single commodity makes up more than three-quarters of total exports. Uncertainty discourages long-term investment and so reduces long-term growth prospects. Is there anything developing countries can do to cushion themselves against these swings?

Countries have tried to stabilise prices by export quotas or by maintaining buffer stocks. But most such schemes have collapsed, mainly because they attempted to support prices at too high a level. The World Bank argues that financial instruments such as futures contracts, swaps and options are a better way for developing countries to hedge their price risk.

At the moment such instruments are not widely used in developing economies. In some countries their use is restricted by foreign-exchange controls. However, the World Bank itself could do a lot more to familiarise governments and firms with the advantages of risk-hedging instruments. A much bigger problem is that countries which lack international creditworthiness are denied the benefits of these financial devices. The World Bank suggests that an international fund could be set up to underwrite counterparty risks on a case-by-case basis. Wall Street to the rescue?